

ETFs and Stressed Markets

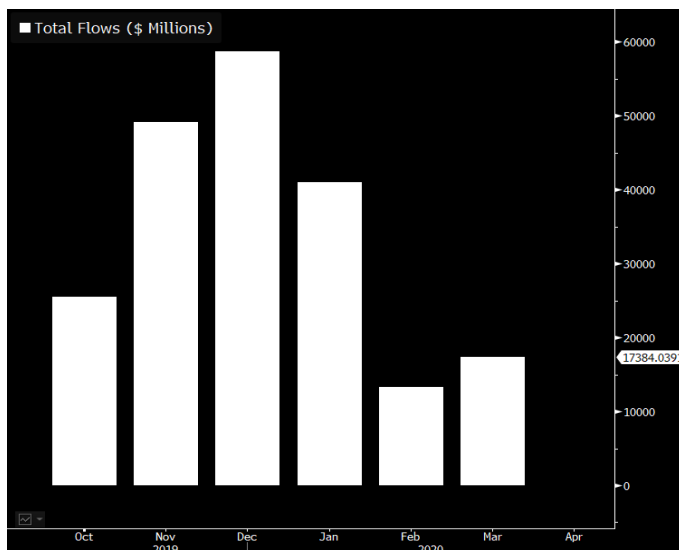
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I would like to address two areas in this article. First, is the ongoing battle that Exchange Traded Fund (ETF) investors are to blame for market volatility. Second, is how ETFs are helping investors with price discovery.

Are ETFs WMDs?

Some asset managers and advisors, all with vested interest in active management, are trying to give ETFs a bad name, referring to them as “weapons of mass destruction” (WMDs). They are all saying that once markets hit a period of stress, ETF investors will exacerbate the moves by selling out hard and fast.

Recently, I read an article quoting the outflows in SPY ETF (representing the S&P 500 stocks) as evidence that ETF investors are running for the exits. I can see why the author chose the SPY. It is the largest ETF in the world by assets and not surprisingly the most active instrument on the stock exchange. However, to cherry pick one ETF as an indication of the ETF industry is misleading. Hat tip to [@EricBalchunas](#) at Bloomberg, for passing this chart along to me. The chart illustrates the ETF fund flows for March coming in at \$17B month to date. Seems like a far cry of investors running for the exits!



Don't get me wrong, we may have more to go to the downside in this market, but let's wait for the dust to settle to see whether active or passive wins with investors. Having discussed this with Eric in the past, we both agree that ETFs will likely come out being the winner from the money in motion to come.

ETFs and Price Discovery

For the third time in a week, volatility ended up triggering “circuit breakers” and trading was halted. For those of you who do not know, a circuit breaker forces a halt in the market once certain levels of selling occur on a percentage basis. Circuit breakers also apply on the futures markets, except they call it “limit down/limit up”. These halts are designed to give investors a pause and possibly re-evaluate the situation.

These halts normally would have left investors flying blind until the stock market opened at 9:30am. Enter the SP500 ETF SPY. SPY is unique in that it trades in the premarket session, in other words before the actual market opens. This feature gives investors and business channel commentators the opportunity to reference point as to where the markets may open by referencing the SPY ETF. In fact, there was trading activity in the most liquid names as represented by the SPY.

Bringing it Together

Investors need to really think critically. When experts use a single reference point to try to indicate investor behaviour, you need to ask for the big picture. When I see this type of referencing, an old axiom comes to mind “Figures don't lie, but liars figure”. There is too much information out there that investors can access and form their own opinions.

There are many benefits of ETFs, I will list but a few: they provide intraday liquidity, low cost of ownership, diversification and tax efficiency. Finally, ETFs also act as a reference point and potential liquidity provider in periods of market stress. Its time to explore and embrace ETFs as part of your investment portfolio.

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